A **KETUA PENGARAH HASIL DALAM NEGERI**

v.

SHIUH DONG INDUSTRIES SDN BHD

B HIGH COURT MALAYA, KUALA LUMPUR
MOHD ZAWAWI SALLEH J
[CIVIL APPEAL NO: R4-14-02-2010]
5 JULY 2011

C ***REVENUE LAW:*** *Income tax - Special Commissioners of Income Tax ('SCIT') - Deciding Order of SCIT - Appeal against - Whether company entitled for double deduction - Whether company an 'importer' - Whether interest expenditure incurred by company were for production of gross income from existing source - Whether deductible under*
D *s. 33(1)(a)(ii) Income Tax Act 1967 - Whether there were circumstances prevailing warranting court to disturb findings of SCIT*

There were two appeals herein, both by way of case stated (CS) pursuant to para. 34 of sch. 5 of the Income Tax Act 1967 ('the
E Act'). The first appeal was from the Director General of Inland Revenue ('the Revenue') relating to a portion of the Deciding Order ('Deciding Order') of the Special Commissioners of Income Tax ('SCIT') regarding double deduction in respect of insurance premium paid and the second appeal was from Shiuh Dong
F Industries Sdn Bhd ('SDI'), a company principally engaged in the business of trading in galvanized iron steel sheet, concerning interest expenditure incurred by SDI. The issues for determination before the SCIT were: (i) whether the Revenue was correct in disallowing a double deduction in respect of insurance premium
G paid for the import cargo insured with a Malaysian incorporated insurance company for the years of assessment 1997, 1998 and 1999 amounting to RM30,858, RM19,900 and RM21,446 respectively, claimed by SDI under the Income Tax (Deductions of Insurance Premiums for Importers) Rules 1982; (ii) whether the
H Revenue was correct in imposing a penalty under s. 113(2) of the Act for the years of assessment 1997, 1998 and 1999 at the rate of 60% with respect to the disallowance referred; (iii) whether interest expenditure of RM87,343 and RM152,450 which were incurred by SDI in the years of assessment 1998 and 1999
I respectively, were incurred for the production of gross income

from an existing source and thereby deductible under s. 33(1)(a)(ii) of the Act. Counsel for the Revenue submitted that it was one Heap Sing Huat Metal & Machinery Sdn Bhd ('HSH'), a related company of SDI, who brought the goods into Malaysia from a foreign country and paid customs duties, thus SDI was not entitled for a double deduction. As for the issues on interest expenditure, according to SCIT, the said interest did not fit the criteria imposed by s. 33(1)(a)(ii) of the Act because the factory building was still not in use for year ending 31 March 1997 and 31 March 1998.

Held (dismissing both appeals with costs; affirming Deciding Order issued by SCIT):

(1) In order to determine whether SDI was entitled for a double deduction, the question of whether SDI was the importer within the ambit of r. 2 of the Act - Income Tax (Deductions of Insurance Premiums for Importers) Rules 1982, ('r. 2') had to be ascertained. According to the *Black's Law Dictionary*, "importer" is a person or entity that brings goods into a country from a foreign country and pays customs duties. Section 2 of the Customs Act 1967 defines the word "importer" as "includes and applies to any owner or other person for the time being possessed of or beneficially interested in any goods at and from the time of importation thereof until such goods were duly removed from customs control". The definitions speak of the general concept of bringing goods into a country. The word is wide enough to include a taxpayer who imports the trade goods using an agent. There was no reason for limiting r. 2 to the person who actually imported the goods such as HSH. (paras 6, 8, 10-12)

(1a) When the goods were brought from another country to this country, the extent of its immunity from taxation turns on the essential nature of the transaction between the parties and not on the formalities with which the importation is conducted or on the technical procedures by which it is effected. The SCIT was correct when they based their findings on the fact that the goods imported were at all material time beneficially owned by SDI and HSH did not, at any time, claim any deduction for the costs of the goods

imported or marine insurance premium. The goods were imported and SDI was the efficient cause of its importation. SDI was the importer within the ambit of r. 2 and hence, entitled for a double deduction under r. 2. The Revenue had no right to impose penalty at rate of 60% against SDI. (paras 14-16)

(2) Reading s. 33 of the Act, only expenses which are "wholly and exclusively incurred during that period by that person the production of gross income and from that source" are deductible. Before the interest payable by SDI could be considered as an expenditure under s. 33 of the Act, the land and the factory must be used or held to produce the gross income of SDI's business which was trading in galvanized iron steel sheet, for year ending 31 March 1997 and 31 March 1998. Unfortunately, it was not the situation in the present case. Both parties were not in dispute on the fact that SDI had obtained a revolving credit facility for the acquisition of a piece of land and construction of a building/factory upon it. However, the facts also showed that in year ended 31 March 1997 and 31 March 1998, the land and the building/factory was still not in use for SDI's business purposes. This was because, it was still under construction and there was no exact date given when the building first started to operate as a factory. There were no circumstances prevailing which warrant this court to disturb the findings of SCIT on this issue. (paras 20-23)

Case(s) referred to:
MP Holdings Sdn Bhd v. KPHDN [2000] MSTC 3 ***(refd)***

Legislation referred to:
Customs Act 1967, s. 2
Income Tax Act 1967, ss. 33(1)(a)(ii), 113(2), sch 5 para 34
Income Tax (Deductions of Insurance Premiums for Importers) Rules 1982, r. 2

For the appellant - Nor Kamaliah FC, IRB
For the respondent - Vijey M Krishnan (FS Kok with him); M/s Raja Darryl & Loh

Reported by Suhainah Wahiduddin

JUDGMENT

Mohd Zawawi Salleh J:

Introduction

[1] There are two appeals before this court. Both are by way of case stated (CS) pursuant to para. 34 of sch. 5 of the Income Tax Act, 1967 ("the Act").

[2] The first appeal is from the Director General of Inland Revenue ("the Revenue") which relates to a portion of the deciding order dated 14 July 2009 ("deciding order") where the Special Commissioner of Income Tax ("SCIT") decided as follows:

> Adalah Diputuskan bahawa perayu berhak mendapat potongan tambahan di atas premium insurans yang dibayar bagi tahun-tahun taksiran 1997, 1998 dan 1999 masing-masing berjumlah RM30,858.00, RM19,900.00 dan RM21,446.00 di bawah peruntukan Kaedah-Kaedah Cukai Pendapatan (potongan premium insurans bagi pengimport) 1982 dan penalti yang dikenakan berkaitan dengan perkara ini mengikut peruntukan s. 113(2) Akta Cukai Pendapatan 1967 hendaklah ditarik balik.

[3] The second appeal is from Shiuh Dong Industries Sdn Bhd, the taxpayer ("SDI") which concerns the other portion of the deciding order which reads as follows:

> Juga Adalah Diputuskan bahawa perbelanjaan faedah berjumlah RM87,343.00 dan RM152,450.00 yang dilakukan oleh perayu masing-masing bagi tahun-tahun taksiran 1998 dan 1999 adalah perbelanjaan yang tidak dibenarkan penolakan di bawah peruntukan s. 33(1)(a)(ii) Akta Cukai Pendapatan 1967 dan penalti yang dikenakan berkaitan dengan perkara ini mengikut peruntukan s. 113(2) Akta yang sama adalah dikekalkan.

Issues For Determination

[4] The issues formulated for determination before SCIT and now before this court are as follows:

(i) whether the revenue is correct in disallowing a double deduction in respect of insurance premium paid for the import cargo insured with a Malaysian incorporated insurance company for the years of assessment 1997, 1998 and 1999 amounting RM30,858 RM19,900 and RM21,446.00 respectively, claimed by SDI under the Income Tax (Deductions of Insurance Premiums for Importers) Rules 1982;

(ii) whether the revenue is correct in imposing a penalty under s. 113(2) of the Act for the years of assessment 1997, 1998 and 1999 at rate of 60% with respect to the disallowance referred to in para. (i);

(the above said two issues are classified and collectively referred as "Issues On Double Deduction").

(iii) whether interest expenditure of RM87,343 and RM152,450 which were incurred by SDI in the years of assessment 1998 and 1999 respectively, were incurred for the production of gross income from an existing source and are thereby deductible under s. 33(1)(a)(ii) of the Act; and

(iv) whether the revenue is correct in imposing a penalty under s. 113(2) of the Act for the years of assessment 1998 and 1999 at rate of 60% with respect to the matter described in para. (iii).

(these two issues are classified and collectively referred as "Issues On Interest Expenditure").

Facts Proved Or Admitted Before The SCIT

[5] Based on the evidence adduced before the SCIT, the following oral and documentary facts were admitted or proved. For ease of reference, it is appropriate that I reproduce them in full:

5.1 SDI is a private limited company and was incorporated under the provisions of the Companies Act, 1965 on 3 January 1992.

5.2 SDI commenced business in the year 1995.

5.3 For the financial years 1996 to 2000, it is stated in the audited accounts of SDI that the company is principally engaged in the business of trading in galvanized iron steel sheet.

5.4 SDI and one Heap Sing Huat Metal & Machinery Sdn Bhd ("HSH") a private limited company incorporated under the provisions of the Companies Act, 1965, are related companies whereby all the shareholders of HSH are also all the shareholders of SDI.

5.5 HSH trades in different products from SDI and would not import or order the goods referred to in paras. 5.6, 5.7 and 5.8 below if not for the arrangement described in the following paras. 5.6, 5.7 and 5.8.

5.6 Purely in order to utilize a letter of credit facility that has been granted by Standard Chartered to HSH, SDI has been using HSH to import trade goods required by SDI ("SDI goods") from overseas suppliers.

5.7 The SDI goods are ordered by SDI directly from the overseas suppliers.

5.8 HSH does not consider the SDI goods to be owned by it and instead considers the SDI goods to be at all times the property of SDI.

5.9 The sums referred to para. 4(i) of the issues for determination relates to marine insurance premium on the SDI goods paid to a Malaysian incorporated insurance company. Whilst the insurance has been obtained by HSH, HSH does not consider itself to be the beneficiary under the policy and is under an obligation to and will forward any claims received under the policy to SDI (if any).

5.10 HSH does not account for or recognize in its financial records and audited accounts any expenditure or cost for the purchase of the SDI goods or the marine insurance premium as it considers such expenditure the expenditure of SDI.

5.11 HSH is reimbursed by SDI at cost (with no mark-up) for the purchase price of the SDI goods as well as marine insurance premium. The exact figure for reimbursement is notified regularly by HSH to SDI via debit notes issued. Consistent with para. 5.10 above, the debit notes in question state that the reimbursement is on account of payment having been made by HSH on behalf of SDI. HSH does not account for or recognize in its financial books and audited accounts and reimbursement for the purchase of the SDI goods or the marine insurance premium.

A 5.12 Consistent with para. 5.10 above, other documents pertaining to the import of the SDI goods such as the Malaysian customs declaration form, bill of lading, packing list and invoice will state SDI as owner or consignee.

B 5.13 Whilst HSH has insurable interest in the goods, the SDI goods are beneficially owned by SDI at all times and HSH does not claim any proprietary rights whatsoever over the SDI goods.

C 5.14 The interest referred to para. 4(iii) of the issues for determination which was incurred by SDI in the years of assessment 1998 and 1999 respectively in relation to a loan for the acquisition of a piece of land and construction for a building thereon.

D 5.15 The interest referred to para. 4(iii) of the issues for determination will be deductible under s. 33(1)(a) (ii) of the Act if it was incurred for the production of gross income from an existing source.

E 5.16 There was no exact date given when was the building first started to operate as factory. No evidence adduced to confirm when the factory was commenced its operation.

F 5.17 Based on the accounts from year ended 31 March 1996 to 31 March 2000, it was stated in the director's report that the principal activity of SDI is engaged in the business of trading in galvanized iron steel and there have been no significant changes in the nature of this activity during that year.

G

5.18 As confirmed by AW1, before the factory started to operate. SDI took orders from customers, sent it to their sister company to cut it according to the specific requirements given by the customers and delivered it to

H their respective customers.

5.19 Only after the factory started to operate around year 2000 and 2001, SDI is involved in manufacturing of galvanized iron steel sheet. They take order from

I customers cut it according to the requirements and deliver it direct to the customers.

5.20 The amount referred in para. 4(iii) of the issues for determination is a trade debt that was reasonably estimated in all circumstances to be wholly irrecoverable at the end of the basis period for the year of assessment 2000 (current year basis).

5.21 The revenue had *via* a notice of additional assessment (Form JA) for the year of assessment 1997 dated 10 September 2003, a letter dated 10 August 2003 and tax computations as set out in the letter dated 10 August 2003:

(a) assessed SDI to additional tax of RM10,499.40 as a result of, *inter alia*, disallowing the double deduction referred to in para. 4(i) of the issues for determination; and

(b) imposed a penalty under s. 113(2) of the Act at the rate of 60%.

5.22 The revenue had *via* a notice of additional assessment (Form JA) for the year of assessment 1998 dated 10 September 2003, a letter dated 10 August 2003 and tax computations as set out in the letter dated 10 August 2003:

(a) assessed SDI to income tax of RM62,857.48 as a result of, *inter alia*, disallowing the amounts described in paras. 4(i) and (iii) of the issues for determination; and

(b) imposed a penalty under s. 113(2) of the Act at the rate of 60%.

5.23 The revenue had *via* a notice of additional assessment (form JA) for the year of assessment 1999 dated 10 September 2003, a letter dated 10 August 2003 and a tax computations as set out in the letter dated 10 August 2003:

(a) assessed that SDI to additional income tax of RM40,515.16 as a result of, *inter alia*, disallowing the amounts described in paras. 4(i) and (iii) of the issues for determination; and

(b) imposed a penalty under s. 113(2) of the Act at the rate of 60%.

A 5.24 The reason why HSH's letter of credit was used was because at that point of time, SDI was not an established company and did not have a letter of credit facility. HSH's letter of credit was used only when a letter of credit was required by the overseas supplier and that
B today, the whole arrangement is no longer in use as SDI is now an established company with its own letter of credit facility.

5.25 The insurer knew about the arrangement above and had
C no issue with it. Based on AW1's testimony, if there is a claim on the policy, HSH will be paid by the insurer and HSH will then pass on the same to SDI.

5.26 There was absolutely no risk that HSH would refuse to
D hand over any insurance proceeds received to SDI as both companies were managed by AW1 and both companies have the same shareholders. By this same reason, it would be strange for the arrangement to be reduced into a formal written contract.

E 5.27 HSH acts as an agent of SDI in the import of the SDI goods whereby (1) HSH acts on the instructions of SDI and represents SDI in dealings with suppliers; (2) neither SDI nor HSH considers HSH to be liable under any contract with the supplier since it is SDI as principal that
F has to be liable to the suppliers; (3) SDI will reimburse HSH for all lawful expenses incurred by HSH on behalf of SDI; (4) HSH views SDI as being bound by any contract that HSH enters into on behalf of SDI and (5) there are times when it is a disclosed agency and there
G are times when it is an undisclosed agency.

5.28 The SDI goods are at all material times beneficially owned by SDI. HSH does not claim any deduction for the cost of the SDI goods or marine insurance premium.
H The marine insurance is incurred by SDI (it has a legal obligation to pay the same).

5.29 A single deduction for the marine insurance is not disputed by the revenue (since clearly the tests under s. 33(1) are
I made out).

5.30 The marine insurance is payable to a locally incorporated insurance company for insurance on import of cargo, as is required under the double deduction order.

5.31 In both HSH's and SDI's line, one cannot just import and sell the product as is. The products come in big coils which are minimum five tonnes. Commonly, customers require the product in various small sizes ranging from 5 to 50 kgs per piece. One cannot trade in these products without cutting it to size. You either cut it yourself or sub-contract the cutting or even both.

5.32 There is no such thing as a pure trade in this line. If one were to import to sell to a company like HSH or SDI, they would not buy the products as they can buy directly from the supplier at cheaper rates.

5.33 It has always been the intention for SDI to have its own building and machinery for cutting. When SDI started in 1995, it did not want to invest immediately in a building and machinery. HSH sells a different product and so SDI's business is a new one. Since HSH had cutting machinery, SDI sub-contracted cutting work to them. This however is not a long term solution since HSH has its own business and cannot be expected to give priority to SDI's work. There is also the issue of capacity as HSH cannot be expected to buy more machinery to cut the SDI's products.

5.34 At the time SDI commenced business, there was no one around that would offer cutting services to SDI since everyone's capacity was full. HSH would offer SDI such services since they are SDI's sister company but this was clearly putting a strain on their activities. This shows that the intention all along was for SDI to have its own cutting capability.

5.35 Within 1 year, that is by 1996, SDI was quite comfortable that its business could succeed and decided to implement the plan to buy land, construct a building and equip the building. They found an ideal location in Bukit Permatang Sena and signed the Sale and Purchase Agreement. In 1996, there were earthworks. Construction started in 1997 and was completed in 1998.

5.36 The financial climate by 1998 was very bad. SDI had intended to commission machinery in 1998 but had to defer this. In the meantime, the building was used as their office.

A 5.37 It also took SDI a while to find the machinery as they wanted second hand machinery. New machinery would be too expensive. SDI commissioned machinery around 2001/2002 and this was when SDI started doing their own cutting. The premises are used for storage of the
B bulk items purchased and the cutting machinery being used.

5.38 Even today, SDI still uses HSH for sub-contract cutting in some instances. This is usually where SDI has
C insufficient capacity.

5.39 If not for the 1998 crisis, SDI would have had the machinery up and running much sooner.

5.40 The land and building are not for investment. It is solely
D for SDI's business of selling products at sizes requested by the customer. The building was constructed to SDI's specification. This was not an investment for resale and it was a special purpose building that no one else would want to buy unless they are exactly the same industry.

E

Findings Of The Court

Issues On Double Deduction

[6] In order to determine whether SDI is entitled for a double
F deduction, the question of whether SDI was the importer within the ambit of r. 2 of the Income Tax Act, 1967 – Income Tax (Deductions of Insurance Premiums for Importers) Rules, 1982 (P.U.(A) 72) ("Rule 2") has to be ascertained.

G **[7]** For convenience, r. 2 is reproduced herein:

2. Deductions

(1) For the purposes of ascertaining the adjusted income of a person from a business under the Act, there shall be allowed
H as a deduction any premium of a kind allowable under s. 33 of the Act payable in respect of insurance of cargo **imported by that person** provided the risks are insured with any insurance company incorporated in Malaysia.

(2) The deduction under these Rules shall be in addition to any
I deduction allowable under s. 33(1) of the Act. (emphasis added)

[8] It is noted that the word "importer" is nowhere defined under r. 2 neither in the Act. So this means, the Parliament intended for the ordinary meaning of these words to apply. A

[9] It is trite that in the absence of any definition of the intended meaning of words or terms used in a legislative act, they will, in the interpretation of the act, be given their common, ordinary and accepted meaning in the connection in which they are used. B

[10] According to the *Black's Law Dictionary*, "importer" is a person or entity that brings goods into a country from a foreign country and pays customs duties. Section 2 of the Customs Act, 1967 (Revised 1980) defines the word "importer" as includes and applies to any owner or other person for the time being possessed of or beneficially interested in any goods at and from the time of importation thereof until such goods are duly removed from customs control. C D

[11] The definitions speak of the general concept of bringing goods into a country. The word is wide enough to include a taxpayer who imports the trade goods using an agent. There is no reason for limiting r. 2 to the person who actually imported the goods such as HSH. E

[12] Learned counsel for the revenue submitted that it was HSH who brought the goods into Malaysia from a foreign country and paid customs duties. Even though SDI and HSH are related companies, it does not change the fact that each of them has separate legal entity. F

[13] The revenue's contention, in my considered view, is untenable. To say that, it would impede the objective of the rule which is introduced to promote cargo insurance with an insurance company incorporated in Malaysia. G

[14] This court is concerned with matters of substance, not of form. When the goods are brought from another country to our country, the extent of its immunity from taxation turns on the essential nature of the transaction between the parties and not on the formalities with which the importation is conducted or on the technical procedures by which it is effected. H I

[15] The SCIT was correct when they based their findings on the fact that the goods imported were at all material time beneficially owned by SDI and HSH did not, at any time, claim any deduction for the costs of the goods imported or marine insurance premium. In addition to that, the revenue themselves had, however, allowed a single deduction under s. 33(1) of the Act on the marine insurance.

[16] In my judgment, what is important, the goods were imported and SDI was the efficient cause of its importation. Being that so, SDI was the importer within the ambit of r. 2 and hence, entitled for a double deduction under r. 2. With respect, the revenue has no right to impose penalty at rate of 60% against SDI.

Issues On Interest Expenditure

[17] The court now turns to the issue whether the interest payable by SDI on a revolving credit facility for the acquisition of a piece of land and construction of a building is deductible under s. 33(1)(a)(ii) of the Act.

[18] According to the SCIT, the said interest did not fit the criteria imposed by s. 33(1)(a)(ii) of the Act. This is because, the SCIT found that the factory building was still not in use for year ending 31 March 1997 and 31 March 1998. It was still under construction and no exact date was known when the building started to operate as factory.

[19] For ease of reference, the relevant provision s. 33(1)(a)(ii) of the Act is reproduced:

> (1) Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that **source for that period all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source**, including:
>
> (a) subject to subsection (2), any sum payable for that period or for any part of that period) by way of interest upon any money borrowed by that person and:
>
> (i) employed in that period in the production of gross income from that source; or
>
> (ii) laid out on assets **used or held** in that period for the production of gross income from that source; (emphasis added)

[20] So reading s. 33 of the Act, it is my considered view that only expenses which are "wholly and exclusively incurred during that period by that person in the production of gross income from that source" are deductible. Being that so, before the interest payable by SDI could be considered as an expenditure under s. 33 of the Act, the land and the factory must be used or held to produce the gross income of SDI's business which is trading in galvanized iron steel sheet, for year ending 31 March 1997 and 31 March 1998. Unfortunately, it is not the situation in the present case before me.

[21] In the instant case, both parties are not in dispute on the fact that SDI had obtained a revolving credit facility for the acquisition of a piece of land and construction of a building/factory upon it. However, the facts also show that in year ended 31 March 1997 and 31 March 1998, the land and the building/factory was still not in use for SDI's business purposes. This was because, it was still under construction and there was no exact date given when was the building first started to operate as factory.

[22] In the case of *MP Holdings Sdn Bhd v. KPHDN* [2000] MSTC 3, the taxpayer obtained a loan to finance the purchase of K Estate and claimed the interest to be deducted under s. 33 of the Act. In rejecting the claim, the court held:

> K Estate was purchased for housing development. Pending the development, any income from the estate was merely incidental to the principal object of the purchase. Therefore any deduction of interest will only arise when the original intention materializes ie, income derived from the housing development in this case.

[23] In the light of the above, I find no circumstances prevailing which warrant this court to disturb the findings of the SCIT on this issue.

Conclusion

[24] Based on the reasons above stated, the appeals are dismissed with costs at RM5,000 of each party and the deciding order issued by SCIT is hereby affirmed.